IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICGTION

INCOME TAX REFERENCE NO. 85 of 1988

M/s. Maharashtra State Financial
Corporation Ltd., ... Applicant.
vs.

The Commissioner of Income Tax,
Bombay City II, Bombay ..... Respondent

Mr. P. J. Pardiwala
i/b. Mulla & Mulla for Applicant.
Mr. Ashok Kotangale for Respondent.

CORAM: V. C. DAGA AND A. S. AGUIAR JJ.

Date: 4th July, 2005.

ORAL JUDGMENT: (Per V. C. Daga J.)

1. This reference is at the instance of the assessee -applicant Maharashtra State Financial Corporation Ltd., under section 256(1) of the Income Tax Act (ITR for short), 1961.

2. The question of law referred to this court is as follows:

3. (1) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in in holding that

interest of Rs.1,16,96,604/- credited to the interest suspense (suit-filed) account and interest suspense (Recalled) account had accrued to the assessee and was chargeable to tax for the Assessment Year 1980-81?"

Factual Matrix

2. The factual matrix reveal that the issue pertains to the relevant accounting year ended on 31.3.1980 (Assessment Year 1980-81). The assessee - Maharashtra State Financial Corporation Ltd., is set up under an Act of Parliament to finance small and medium scale industries. The assessee – Corporation fled its return for the Assessment Year 1980-81 declaring its income in the sum of Rs.2,34,99,280.

3. The Income Tax Officer amongst others considered the taxability of the amount credited (a) "Interest Suspense (suit filed) Account" amounting to Rs.59,57,822/- and, (b) Interest Suspense (Recalled) Account" amounting to Rs.57,38,782/- . The I. T. O. found that these two amounts put together amounting to Rs.1,16,96,604/- were taxable as the assessee was maintaining its accounts on mercantile basis. This view was taken relying on the decision of Kerala High Court in the case of **State Bank of Travancore vs. C. I. T.,** reported

in **(1971) 110 ITR 336**.

4. Being aggrieved by the aforesaid order the assessee – Corporation preferred an appeal before the Commissioner of Income Tax (Appeals). The said Appellate Court following the decision of the Tribunal for the earlier year i.e., Assessment Year 1978-79 held that this amount was not taxable on accrual basis but was taxable on realization basis, consequently, it deleted the said addition.

5. The matter was carried to the Tribunal at the instance of the Revenue in appeal. Before the Tribunal reliance was placed by the Department on the decision of the Supreme Court in the case of **State Bank of Travancore (1986) 158 ITR (102 SC)** wherein the Supreme Court held that in the case of assessee following mercantile system of accounting, interest income accrued to the assessee was assessable irrespective of whether the assessee had credited such interest to interest suspense account. It is not in dispute that the assessee was debiting the amount of interest on accrual basis to the debtor's account and was crediting the same to interest suspense account in respect of advances known as sticky advances. This was in contrast to the accounts of debtor's who were considered good. In whose cases interest accrued was being

debited to the debtor' saccount and accordingly credited to the interest account. The credit balance in the interest – account was taken to profit and loss account at the end of the y year while credit balance in the "Interest Suspense Account" was not carried to the profit and loss account.

6. After the Financial Year 1978-79, the assessee made a change in the system of account. While the debit regarding accrued interest was made to accrued interest suspense account and not to the account of the debtors, credit was given to "Interest Suspense (Recalled) Account" instead of Interest Suspense Account on a . Subsequently when the interest was received from the debtor, credit was given to "Accrued Interest Suspense Account" from where the same amount was transferred to interest on loan account. The net result of these entries was the same as before financial year 1978-79 viz., that the accrued interest continued to be accounted for in assessee's account books though such interest was not shown as income in the profit and loss account. Thus the assessee, according to what was stated on its behalf, continued to follow mercantile system of accounting by accounting for the dues from the debtors on accrual basis. On these facts the Tribunal found that assessee did not change its system of accounting for mercantile cash. It is further

made clear by the assessee that on filing a suit against the debtors, the assessee credited the interest earned thereafter to Interest Suspense (suit filed) account. Thus, even in respect of accounts where suits were filed, the assessee's system of accounting continued to be mercantile.

7. The Tribunal thus held that the Supreme Court decision in **State Bank of Travancore** (supra) , squarely applied to the facts of the case of the assessee. According to the said judgment of the Apex Court, the distinguishing feature of the mercantile system of accounting was that "it brings into credit what is due, immediately it become legally due and before it is actually received; and it brings into debit, expenditure, the amount for which has been legally incurred before it is actually disbursed".

8. The Tribunal applying the above test has also observed that the Supreme Court had approved the decision of Bombay High Court in **CIT v. Confidence Ltd., (1973) ITR 292** wherein it was held that receipt of income either actual or deemed is not a condition precedent to taxability and it is assessable if it had arisen or accrued. Following this decision the Tribunal held that the amount shown in "Interest Suspense (suit filed) Account" amounting to Rs.59,57,822/- and

"Interest Suspense (Recalled) Account", amounting to Rs.57,38,782/- was assessable. It is out of this finding of the Tribunal that the assessee has sought to raise the above mentioned question.

9. As already stated herein above, the amount of RS.57,38,782 represents the "Interest Suspense (Recalled) Account". So far as the "Interest Suspense (suit filed) Account" is concerned it represents Rs.59,57,822. How this amount should be dealt with is now covered by the Circular issued by the Central Board of Direct Taxes, under section 119 of the Income Tax Act , by which the Board has decided that interest in respect of the doubtful debt deducted by the banking company would be subject to tax but the interest charged in the account where there has been no recovery for consecutive three accounting years will not be subject to tax in the fourth year and onwards. The circular also states that if there is any recovery, the actual amount recovered only would be subjected to tax in the respective years. This procedure would apply to the Assessment Year 1979-80 and onwards. The Tribunal while deciding appeal before it relied on the said judgment of the Apex Court in the case of **State Bank of Travancore (supra),** decided by the Apex Court. However, this judgment of the **State Bank of Travancore (supra)** was explained by the Apex Court in its subsequent judgment in the case of **UCO Bank vs. Commissioner of Income Tax**, reported in

[1999] 237 ITR 889, wherein the Apex Court held that in view of the circular dated 9th October 1984 the interest in the suspense account should not be taxed. The Apex Court itself ruled that the circular issued by the CBDT was not brought to the notice of the Court when the case of **State Bank of Travancore (supra),** was decided by it and as such it was not followed in the UCO Bank case. Since the circular was binding on the assessing authority the interest on the arrears could not have been taxed. In this view of the matter the Tribunal was not justified in taxing the amount of Rs.57,38,782.

10. Now what remains to be considered is the amount of interest shown in the "Interest Suspense (Recalled) Account" amounting to Rs.59,57,822. The learned counsel appearing for the assessee submitted that the award of interest for the period subsequent to the fling of the suit till the date of decree, lies within the discretion of the court and as such the interest from the date of filing of the suit is not liable to tax each year, on the premise that the interest had continued to accrue from year to year. In support of this submission, he placed reliance on the decision of the Calcutta High Court, in the case of **Commissioner of Income Tax, West Bengal -IX vs. Naskarpara Jute Mills Co., Ltd., reported in [1983] 141 ITR 384**

and in the case of Commissioner of Income Tax vs. Orissa State Financial Corporation, reported in **201 ITR 595 (Orissa).** A reading of section 34 CPC, it is clear that the interest from the date of suit till the date of decree is a matter within the discretion of the court passing the decree. At the time of filing of the suit for recovery of the debt, the assessee had merely right to claim for interest, that right to grant further interest is in the discretion of the Court. Consequently right to receive future interest comes in picture when the court passes the decree, from the date of the suit, as was determined by it, with, interest, could not be assessed to tax. We agree with the view taken by the Calcutta and Orissa High Court in this regard.

11. In view of the above in our view the amount of Rs.59,57,822/- could not have been added to the total income, as interest income. Consequently, the Tribunal was not justified in reversing the order of the Commissioner of Income Tax (Appeals). In the result we answer the question in the negative, that is, in favour of the assessee and against the revenue. Reference disposed of accordingly, with no order as to costs.

(V. C. DAGA J.)

(A. S. AGUIAR J.)